

DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 98-0558
Sales and Use Tax
For the Years 1995, 1996, 1997

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ISSUE

I. Sales and Use Tax- Manufacturing Exemption

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-3, 45 IAC 2.2-5-10 (c), Gross Income Tax Division v. National Bank and Trust Co., 79 N.E. 2d 651 (Ind. 1948), Indiana Department of Revenue v. Cave Stone, 457 N.E. 2d 520 (Ind. 1983).

The taxpayer protests the assessment of use tax on three items.

STATEMENT OF FACTS

The taxpayer is engaged in the processing of food products. Its customer is a major fast food chain. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional use tax, interest and penalty after an audit. The taxpayer protested the assessment and a hearing was held.

I. Sales and Use Tax-Manufacturing Exemption

DISCUSSION

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used or consumed in Indiana. A number of exemptions are available from use tax. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., 79 N.E. 2d 651 (Ind. 1948). IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication. . . of tangible personal property."

The taxpayer protests the assessment of use tax on a laser printer, a conveyor belt and the flour corn machine used during the packaging of the product. The first issue to be determined is whether or not these items are used during or after the production process. 45 IAC 2.2-5-8 (d) defines the production process as follows:

Pre-production and post-production activities. “Direct use in the production process” begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging if required.

The items are packaged in small groupings within plastic wrap to maintain freshness. The groupings wrapped in plastic are then transported to the boxing area on conveyer belts. The boxes are assembled and moved on a conveyor belt to the packaging area where the product is inserted. The flour corn machine is a mechanical device that presses the product during placement into the cardboard boxes. The laser prints information such as weight, count, supplier, run number and date directly onto the box. This information is not for the taxpayer’s internal inventory control. Rather, the customer restaurants require the information so they know exactly what foodstuffs they are receiving and when and where the foodstuffs were produced, allow discussion of the quality of the product and to accommodate a recall if necessary. The customer restaurants are the final consumers of the product. They do not resell the plastic wrapped small groupings of the product. The restaurants take the product out of the plastic wrapping and serve them as part of a meal to their patrons. After the information is printed on the assembled and filled box, the taxpayer has completed the required packaging or production as defined in the regulation. Each of the items in the taxpayer’s protest is used during the production process.

Secondly, it must be determined if the protested items qualify for exemption as directly used in the direct production of the taxpayer’s product.

In Indiana Department of Revenue v. Cave Stone, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on foodstuffs and required packaging property during the production process.

Each of the protested items has a direct effect on the production of the taxpayer’s final product. The processed food would not be marketable to the taxpayer’s customers, the fast food restaurants, if the protested items did not perform their functions in the packaging of the foodstuffs. Each of the protested items is necessary and essential in the production of the taxpayer’s final product.

FINDING

The taxpayer’s protest is sustained.